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C O N F I D E N T I A L SECTION 01 OF 03 TASHKENT 000441

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AMEMBASSY NEW DELHI PASS TO AMCONSUL HYDERABAD  
AMEMBASSY HELSINKI PASS TO AMCONSUL ST PETERSBURG  
AMEMBASSY MOSCOW PASS TO AMCONSUL VLADIVOSTOK  
AMEMBASSY MOSCOW PASS TO AMCONSUL YEKATERINBURG

C O R R E C T E D C O P Y (ADDRESSEES)

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SUBJECT: Uzbekistan: World Bank Official Discusses Economic  
Conditions

TASHKENT 00000441 001.2 OF 003

CLASSIFIED BY: Steven Prohaska, Second Secretary, P/E Office; REASON:  
1.4(B), (D)

11. (C) Summary: In a March 24 meeting with us, a World Bank economist discussed Uzbekistan's economy and the effects of the global financial crisis on it. Despite the limited exposure of Uzbekistan's financial sector to global markets, the slow-down in construction abroad (particularly in Russia) may adversely affect the remittances that a large number of Uzbek migrant workers send back to their families in Uzbekistan. The Government of Uzbekistan (GOU) enjoys a budget surplus from which it can finance further anti-crisis measures. Thanks to rising prices for its gold exports, lower but still-comfortable rates for cotton exports, and high prices of 300 USD per thousand cubic meters of Uzbek natural gas, some in the GOU appear to believe that these can enable it to ride out the hard times. Potential GOU measures to stave off a social crisis could include diverting a greater proportion of natural gas toward domestic consumption and increasing wages. The economist considered the GOU's support of business and plans to privatize the two largest state-owned banks to be positive developments, while Uzbekistan's closed trade policy gave him cause for concern. End summary.

12. (C) On March 24, we met with World Bank economist Eskander Trushin, who discussed economic conditions in Uzbekistan and the effect of the world financial crisis on the country. Trushin said that Uzbekistan had escaped being directly affected by the global financial crisis. The financial sector has been largely unscathed due to Uzbek banks having only 4-10 percent exposure to global markets.

Return of Migrant Workers  
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13. (C) Trushin noted that estimates of the number of Uzbek migrant workers abroad vary--he said these range from 500,000 to five million--but his personal opinion was that the true figure is somewhere around 1-1.5 million. (Note: An official from the Russian Embassy in Tashkent told us in 2007 that the figure was around one million. End note.) Some 85-90 percent of Uzbekistan's remittances come from Russia, but Russia had imposed a dramatic

reduction on the number of migrant workers who can work in the country. Some of Uzbekistan's migrant workers who were not involved in construction remained in Russia, but a large number of Uzbek workers (mainly from the Ferghana Valley and Samarkand) returned in November. This has not put much pressure on Uzbekistan yet because they brought a large amount of money back that is tiding them over for now. About half of the workers in Russia were involved in construction, but the credit crunch has adversely affected this industry in particular. The impact may become clearer by this summer. (Comment: Uzbek migrant workers involved in construction may not have jobs waiting for them when they try to return to Russia soon. End comment.) Trushin added that the International Monetary Fund may have additional figures on remittances in June or July.

#### Uzbekistan's Anti-Crisis Measures

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14. (C) The GOU is aware of the potential for social problems. When asked what the GOU or the international community could do to stave off the outbreak of tensions, he replied that an important issue for near-term stability would be good relations in the region on water supply issues. He also noted that while much natural gas is exported, the GOU could divert some of this toward domestic consumption if necessary in order to prevent a social crisis. Continued wage increases would be another method the GOU could use.

15. (C) He believed that the GOU's measures to address the effects of the crisis in Uzbekistan have been generally effective so far. These measures have focused primarily on supporting the export market rather than establishing social security nets, but he didn't expect this to be problematic. First, the GOU enjoys a budget surplus of approximately five percent of GDP, from which it is able to fund its anti-crisis measures. If the GOU determines in the future that more or different measures are required, it should be

TASHKENT 00000441 002.2 OF 003

able to continue financing these measures from the budget without dipping into its reserves. (He noted that official reserves stand at 9-10 billion USD). Second, the prospects for export markets are bright. While commodity prices had dropped, the price of gold--Uzbekistan's primary export--is still rising, and the GOU had managed to lock in a price of 300 USD per 1,000 cubic meters for natural gas for the first two quarters of the year. Cotton prices had decreased by 15 percent, but considering that cotton prices had jumped by 40 percent recently, a 15 percent decline still left cotton prices at a comfortable level. The GOU appears to believe that it could simply allow commodity prices to carry Uzbekistan through the hard times, and Trushin did not disagree with this view.

16. (C) Uzbekistan has a current account surplus of about 13 percent (it had been reported initially as 18 percent, but the IMF "found some errors and improper accounting," primarily in the classification of remittances, and insisted that they revise the number.) He expected that Uzbekistan would maintain a current account surplus into the next year. The only aspect of the GOU's plan that could be considered to have domestic effects was the amount earmarked for infrastructure spending, but he was unsure to what extent that would generate significant employment opportunities.

#### Focus on Capital-Intensive Industries

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17. (C) Trushin noted that both in terms of crisis measures and general philosophy, the GOU's focus has been on developing capital-intensive industries, not labor-intensive industries. This was because the GOU "didn't study world markets." Trushin considered this focus on capital-intensive industry to be short-sighted, but because of the prospects for commodity prices, this short-sightedness would not be crippling for the economy over the near-term.

GDP Growth has had Little Effect on Poverty

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¶18. (C) The World Bank has been unable to obtain raw data to assess poverty trends in Uzbekistan. The Government of Uzbekistan had provided raw data based on household budget surveys in 2000 up until 2003, then stopped. Based on the numbers the World Bank does have, the number of people considered to be below the poverty line has gone from 27.5 percent in 2000 to 23.8 percent in 2007, even though the cumulative GDP growth over the same period was some 40 percent. The reason for such poverty inelasticity, he said, was that all the growth had been in exports and proceeds had flowed into government coffers rather than to the population. He also noted that GDP in 2008 had been about 33 billion USD.

#### Russian and Chinese Investment in Uzbekistan

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¶19. (C) Trushin had seen no real change in Russian investment (90 percent or more of which goes into oil and gas) in Uzbekistan. The 2009 data is not yet available. China's economic presence has come from offering credit instead of foreign direct investment. Trushin noted that Uzbekistan borrows a lot from China, and has been purchasing Chinese rail, construction, and excavating equipment.

#### Positive and Negative Economic Trends

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¶10. (C) Trushin noted positive and negative developments that could affect Uzbekistan's economic growth potential over the next 10-20 years. On the positive side, the GOU has been taking significant steps to support business, particularly small and micro business, and this may yield real results. The number of small businesses has been growing, though slowly. The government has moved to a single unified tax for small and micro businesses and reduced the total amount of taxes on these from 15 percent to eight percent.

TASHKENT 00000441 003.2 OF 003

It has also cut the profit taxes for other businesses. In the financial sector, the GOU has increased the capital base for most banks to 2.5 million Euro for small private banks and to five million Euro for joint-stock government-owned banks. He also saw the upcoming privatizations of the two largest Uzbek banks as a positive sign. According to official pronouncements, one of the two major state banks (Asaka) is to be privatized later this year, while the other (National Bank of Uzbekistan) is slated to begin privatization next year.

¶11. (C) On the negative side, he said that Uzbekistan's trade policy remains "very closed" with "no signs of improvement." The state is highly involved in trade policy and "inappropriate targeting" of specific sectors. Taxes and tariffs are a major barrier to trade. Uzbekistan has given most-favored-nation (MFN) status to 38 countries, and import tariffs for these countries fall into bands of 0, 5, 10, and 30 percent. Non-MFN rates are double these. The overall average import tariff is 14 percent and the weighted average is 16.6 percent. Despite these high numbers, the average import duty collected is only 3.7 percent because of the large number of exemptions granted, in particular for the import of goods needed to support Uzbekistan's capital-intensive industries. There is also an excise tax of about 39 percent, a value-added tax, and a surcharge for goods without a certificate of origin of about 20 percent. He emphasized that all of these taxes are cumulative--each new level of taxes is calculated based on the value of the goods plus all of the previously-applied taxes. All of this tax revenue goes to the central government. The only taxes that local authorities collect are property and land taxes.

Comment:

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¶12. (C) High commodity prices and limited exposure to global financial markets are insulating Uzbekistan's economy to some extent from the effects of the global financial crisis, and IMF officials have recently projected continued strong growth for Uzbekistan's GDP in 2009. Nevertheless, GOU officials are probably

monitoring economic conditions in Russia and Kazakhstan closely. Exports of capital-intensive goods to these countries and remittances from Uzbeks working there (the value of which nearly doubled in 2005-2006 and nearly doubled again 2007-2008) are among the pillars that Uzbekistan's recent export-driven economic growth has rested upon. The potential disappearance of construction-related jobs for Uzbek migrant workers in Russia this year could be damaging to many citizens in the Ferghana Valley and Samarkand, and the possibility of this translating into social unrest in these provinces later this year remains an area to watch.

¶13. (SBU) Even President Karimov admits that some negative impact is likely. In his latest policy pamphlet, he says that positive economic trends last year "in no way mean that the ever-expanding global financial crisis shall not have its impact on our country and bypass us. This would be the most naive and I would say unforgivable delusion."

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